

**JUDICIAL COUNCIL OF CALIFORNIA
ADMINISTRATIVE OFFICE OF THE COURTS**

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Report

TO: Members of the Judicial Council

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DATE: August 27, 2004

SUBJECT: Criteria for Reimbursement of Trial Court Trust Fund Reserves
Utilized to Offset a Portion of the Fiscal Year 2004–2005 Unallocated
Reduction (Action Required)

Issue Statement

At its July 7, 2004, business meeting, Administrative Office of the Courts (AOC) staff provided the council with recommendations for a methodology to allocate to the trial courts anticipated one-time and ongoing unallocated reductions of \$55 million and \$20 million, respectively, in fiscal year (FY) 2004–2005.

As part of the recommendation, it was proposed that trial court reserves above 10 percent of the FY 2004–2005 annual Trial Court Trust Fund (TCTF) allocations, plus any confirmed legally committed reserves and funding set aside for essential projects, be used as an offset to the overall reductions. In addition, to the extent a court received a reduction in reserves, a recommendation would be made to the council at a future meeting to provide for a reimbursement to those affected courts at a rate not to exceed 50 percent of the amount of the identified excess reserves. During the council's discussion, it was expressed that those courts affected by the reduction in reserves should be the first to receive one-time financial assistance should it be deemed necessary to address essential business needs or operational deficiencies. Reimbursements would be subject to an improvement in the state fiscal environment, and should occur no later than June 2009.

The council approved the recommendations, and directed staff to provide for its consideration the methodology that would be used to determine the reimbursement of TCTF fund reserves at the August 27, 2004, business meeting. The council further

directed that the reimbursement of reserves should be subject to the court's having an identified business need for the funds.

Recommendation

Staff recommends that the Judicial Council approve the proposed criteria for determining the reimbursement of TCTF reserves to those courts that received a reduction in reserves as follows:

1. Reimbursement can be provided up to the level of 50 percent of the TCTF reserves the court contributed to the one-time reduction, less an offset for 1) the 50 percent one-time reduction credit applied as an offset to the court's share of the statewide unallocated reduction in fiscal year 2004–2005, and 2) the total of all new funding provided to the court in FY 2004–2005 and following fiscal years to resolve underfunding issues. Any reimbursement must meet the following criteria:
 - The amount of reserves to be reimbursed, added to a court's current TCTF reserves, cannot exceed the Judicial Council approved reserve level (the council-approved threshold for FY 2004–2005 is 10 percent of annual allocations, or \$100,000, whichever is greater, plus funding needed for legally committed reserves and confirmed essential projects).
 - The court must have an identified essential business need for existing operations that cannot be addressed without additional one-time funding.
2. Any reimbursements provided in accordance with the preceding criteria cannot be made prior to July 1, 2005, and must be made prior to June 30, 2009.
3. Requests for reimbursement of reserves must be submitted to the trial court's respective regional administrative director. An executive management committee, consisting of the Chief Deputy Director, each regional administrative director, and the director of the AOC Finance Division will review, consider availability of one-time funding, and make recommendations on each request to the Judicial Council.

Rationale for the Recommendation

In recognition of their contribution in addressing the FY 2004–2005 one-time unallocated reduction, trial courts that had a reduction in TCTF reserves should be the first to receive one-time financial assistance to address essential business needs, via reimbursement of reserves, as prescribed in the proposed methodology. The reimbursement must be in compliance with the council's approved policy for trial court reserves.

Alternatives Considered

In addition to the proposed recommendation, staff considered two other alternatives:

- Retention of 100 percent of the reserves taken, with no opportunity for the courts to obtain reimbursement at any level. Staff did not recommend this alternative because it would be a harsh treatment of those 19 courts that had reserves reduced to alleviate the impact of the unallocated reductions for all courts statewide. Not allowing these courts an opportunity to recover some level of their reserves when one-time funds become available would demonstrate a lack of regard for their contributions in the current poor fiscal environment.
- Consideration of the reallocated reserves as a no interest loan to the TCTF. This would create an obligation for repayment from the TCTF, with the implication that courts are entitled to reimbursement, regardless of the need for the funds. In addition, this could create a conflict with the council-approved reserve threshold, as the amount reimbursed could be above the approved reserve limit.

Comments from Interested Parties

While trial court budget reports are not subject to public comment, on August 9 2004, the proposed criteria was sent to the 19 trial courts impacted by the reductions for comment. In general, the comments, which were received from five courts, expressed displeasure with having the reserves reduced to meet the one-time allocation. In addition, the reserve reduction policy was viewed as punitive for courts had been fiscally responsible, and a reward for those courts that had not planned for the future. Finally, courts expressed skepticism that the proposed criteria for reimbursement of reserves would result in an impacted court realizing a reimbursement of their reserves, particularly as related to the requirement that the court have an essential business need for the funds.

On August 16, 2004, the Trial Court Executive Management Budget Working Group met via conference call to review the draft methodology and the trial court comments. The working group discussed possible revisions to the proposed methodology that might address the courts' concerns, to the extent possible. By consensus of the working group, the proposed methodology was revised as follows:

1. The requirement for a business need for funds was changed from "critical" to "essential", and now reads, "The court must have an identified essential business need for existing operations that cannot be addressed without additional one-time funding". The working group believes the change makes the criteria less subjective (i.e., essential vs. critical) and broadens the basis upon which a court can apply for reimbursement of reserves.
2. Reimbursement is no longer contingent upon an improvement in the state fiscal environment. The methodology now reads, "Any reimbursement provided in accordance with the preceding criteria cannot be made prior to July 1, 2005, and must be completed prior to June 30, 2009". With the implementation of funding based on the State Appropriation Limit, it is likely that FY 2004–2005 will be the

last year that trial courts will have reductions taken. If this is the case, we should begin to realize savings in FY 2005–2006, which could be used for one-time reimbursement of reserves.

3. A process for review of requests for reimbursement of reserves was added to the methodology. Requests for reimbursement will be submitted to the court's regional administrative director. An AOC executive team comprised of the Chief Deputy Director, the three regional directors, and the director of the AOC Finance Division will review, consider availability of one-time funding, and make recommendation to the Judicial Council on each request. This review process is consistent with the appeals process for trial court budget requests that has been in place for several years, as well as the process that was used to review trial court reserve reduction appeals.

A summary of the trial court comments and the AOC response is included as an attachment to this report. This summary will also be sent to the 19 impacted trial courts.

Implementation Requirements and Cost

No additional funds will be needed to implement the recommendation.

Methodology for Reimbursement of Trial Court Reserves Summary of Trial Court Comments

On August 9, 2004, the proposed *Methodology for Reimbursement of Trial Court Reserves* was sent to the 19 courts that were impacted by the reserve reduction for comment. On Friday, August 13, comments were received from 5 courts.

Court	Comments	Response
Comments on accumulated reserves		
Sutter	<p>1. The reason many courts accumulated reserves was because they would not commit one time funding to ongoing needs, primarily critically needed staff, which they could not provide under the baseline. To allow recovery if reserves drop below 10 percent (if funding is available) for critical one-time needs does not address the problem. The courts that had excess reserves were almost all courts that were deemed underfunded, which translates to understaffed.</p>	<p>1a. The reference to 10 percent in the proposed criteria is based on the current Judicial Council-approved reserve limit. The council has directed that staff review the appropriateness of the current reserve limit, and present further recommendations on the implementation of the reserve policy at a future council meeting. Reimbursement of reserves in the future will be based on the council-approved reserve limit in place at the time the reimbursement request is received.</p> <p>1b. Of the 19 courts that were impacted by the reserve reductions, 6 courts have been determined to be “underfunded”. Staff does not believe that retaining one-time savings (reserves) is the answer to these courts funding problems.</p> <p>1c. At the August Judicial Council meeting staff will request approval from the council to submit two Budget Change Proposals (BCPs) in the fall. The first BCP would address ongoing structural deficiencies in the areas of new judgeships; historical base budget underfunding; provision of security that is below established security standards and the provisions of</p>

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Court	Comments	Response
		<p>Senate Bill 1396, where the provisions still apply; and any other identified substantive ongoing structural deficiency. The second BCP would address the current FY 2004–2005 unfunded mandatory needs in the areas of court employee salaries, health benefits, and retirement; security salaries, benefits, and retirement; and increased charges for county provided services.</p> <p>In addition, if current year funding is determined to be appropriate, staff will bring such proposals to the council for their consideration later this fiscal year.</p>
Tehama	<p>2. Further thought needs to be given to the concept of “one-time funding”. In this era of grant funding we often fund projects, which we hope will be ongoing, but which lack ongoing funding. For example, if a court has security needs, is it not better to provide adequate security through reserves while you can rather than be committed to a concept of “one time funding”? If a court enters into a 3-year labor contract, is that an ongoing cost or a one-time 3-year cost? Those issues are not always so clear. Certainly, it should be of concern that courts don’t use “one time funds” for ongoing costs. It may not be fiscally prudent.</p>	<p>2a. Staff agrees that a three-year labor contract is a one-time three-year cost, and such one-time agreements are an appropriate use of reserves. However, since these costs are being funded annually, and retention of reserves for this purpose is being offset by future increases, the Appeals Committee decided to only allow use of reserves above the 10 percent level for this purpose through FY 2004–2005 (with appropriate offsets).</p>
Colusa	<p>3. I do not believe the Judicial Council (and apparently the AOC) realizes that this court, as well as many others, put money aside for the hard times, and that we had some plans for some of the money kept in reserve. Our staff</p>	<p>3a. The Judicial Council recognizes that there is a need for courts to retain reserves for unanticipated circumstances. Both the council-approved reserve limit policy, as well as the deficiency process was</p>

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Court	Comments	Response
	(already well below the state averages) worked with even more dedication and with more responsibility because we choose to leave a position vacant for almost two years so that we could protect our staff if the State once again failed to come through. We did without many niceties to insure that we have a cushion.	developed to provide some relief to the courts when unforeseen expenses occur. However, the current level of unallocated reductions imposed on the judicial branch has created hard times for all trial courts, and the reserve reduction policy approved by the council to use excess reserves to address this need was for the greater good of all trial courts statewide. Even so, only those reserves that had not been designated for use by a court were considered excess reserves, and as such were subject to the reserve reduction. The initial determination of excess reserves excluded confirmed legally committed reserves or funding set aside for critical projects as reported reserves in both the FY 2003–2004 Schedule 1 and the second quarter Quarterly Financial Statement (QFS), and focused on whichever was lower. Courts were also afforded the opportunity to provide additional information and documentation related to the need to retain reserves in the appeals process. As a result of the appeals process two courts that were slated for one-time reserve reductions subsequently had no reserves taken. Of the total amount appealed \$9,003,578, or 48 percent, was approved for retention by the courts.
Methodology will not provide an actual reimbursement of reserves		
Tehama	4. The problem that I have with the proposed methodology is that it is not so much a methodology for reimbursement, as it is for avoiding reimbursement. Courts would only be reimbursed if their reserve level	4a. Refer to response 1a.

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Court	Comments	Response
	<p>did not otherwise exceed 10 percent (or \$100,000). The 10 percent cap is an arbitrary level that has not been approved, and which to date only applies to the current fiscal year.</p>	
Kern	<p>5. I believe the methodology proposed is a contrived effort to mollify courts impacted by the sweep while ensuring little if any opportunity to actually obtain return of their hard earned savings. It is interesting that no other courts are required to provide a “critical business need” to retain their allocations. Again, the different threshold underscores the perception of unfairness.</p>	<p>5a. The requirement that there be a business need for the reimbursement is included in the methodology on the specific direction of the council. The proposed methodology is a good faith effort to provide court’s impacted by the reserve reduction an opportunity to obtain reimbursement of one-time reserves. The proposed methodology has been revised in consideration of trial court concerns about the requirement for a “critical” business need. The standard has been changed from “critical” to “essential”, and now reads, “The court must have an identified essential business need for existing operations that cannot be addressed without additional one-time funding”. The change makes the criteria less subjective (i.e., essential vs. critical) and broadens the basis upon which a court can apply for reimbursement of reserves.</p>
Tehama	<p>6. The methodology boils down to this: it is a promise to reimburse the affected courts, if money is available for “up to 50 percent of the reserve contribution” IF “we” don’t believe the court has too much money already and IF “we” approve of the things the court wants to spend it on. The methodology may result in an increase in funding to address “critical needs”, but it really only</p>	<p>6a. Refer to response 5a.</p>

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Court	Comments	Response
Colusa	creates an illusion of reimbursement.	
	7. The court strongly disagrees with the methodology. One reason is that it is a methodology for denying any “reimbursement” of trial court reserves. The methodology proposed by you/AOC says that no courts will get any of their reserves back unless AOC thinks it is a good idea. At best, the recommended methodology is an illusory offer. The “donor” courts had an olive branch of 50 percent refund held out to them. No “real” refund is offered.	7a. Refer to response 5a.
Methodology penalizes fiscally prudent courts		
Tehama	8. The methodology fails to consider the fact that court-funding priorities have been severely altered due to the current change in policy. Prior to this year, trial courts had at least implied assurance that reserves would be kept by the individual trial courts. What is ironic is that this methodology apparently only applies to courts that have not been fiscally imprudent.	8a. A primary reason for taking this approach was the unequal impact the method used in prior years of applying a pro-rata reduction across all trial courts had on the courts. The use of one-time reserves provides a more equitable way to distribute the reductions. Staff considered a prorated method of allocating reductions based upon each court’s baseline allocations (excluding juror, interpreter, and court appointed counsel). However, this method did not address court needs because it did not take into consideration each court’s level of resources as compared to their workload, nor did it reflect the disparate impact that an across-the-board reduction would have on courts with different levels of resources. Another option considered was to not take into account the reserves as part of the reductions, which would have resulted in increasing the percentage

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		<p>reduction to every court by approximately 50 percent. However, due to the wide variance in the level of reserves, ranging from less than 1 percent to 120 percent of a court's total budget (including security), it did not appear equitable to allow some courts to continue to absorb the reductions with no impact to their operations, while others would have had to institute severe budgetary constraints. While we recognize that there was a conscious effort on the part of some courts to build reserves, the reason for the significant disparity in reserve levels does not necessarily mean that courts that do not have significant reserves have been fiscally imprudent.</p> <p>Staff have reviewed budget augmentations received by trial courts throughout the state and have identified a great variance between the levels of funding growth that have been experienced by courts since fiscal year 1997-98. For some courts, the growth in funding has exceeded 100 percent of their base allocation in 1996-97, thus effectively doubling their budget, with one court's budget having increased by 130 percent. Funding growth for other courts has been below 10 percent, with one court's allocation having grown less than 2 percent since 1997-98.</p>
Colusa	9. I am not going to throw stones at other courts, however, I resent that those who did not cut back are now having the benefit of our sacrifices. Additionally, I resent those who believe that they have an "entitlement" to the reserves	<p>9a. Refer to response 8a.</p> <p>9b. Government Code Section 77203, gives the Judicial Council authority to authorize trial courts to carry</p>

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Court	Comments	Response
	that we worked so hard to save. Frankly, I am angry and upset with a policy that penalizes this court for good business practices and rewards others who did not save as well.	over funding between fiscal years; however, due to the ongoing fiscal crisis in the State, the Governor and Legislature are continually looking for ways to improve the State's fiscal outlook. By maintaining significantly high reserve levels, the trial courts risk the scrutiny by the State, with the possibility of having reserves swept. The Judicial Branch, as the third branch of government, has a responsibility to the public to ensure fair and equitable access to justice. The council's approved policy for reserve reduction was both a proactive approach to the branch governing its own finances, and a fulfillment of its responsibility to the public.
Alternative Recommendations		
Sutter	10. It is extremely doubtful that any court that lost reserves will ever be able to recover anything, let alone up to 50 percent, under this policy as proposed. Forget one-time reserves; adjust baselines to adequately meet on-going operational needs.	10a. Refer to response 1b.
Kern	11. Recommendation would be to return these resources by utilizing them to move the impacted courts facilities projects up in priority on the proposed capital outlay plan. There is no better measure of "critical business need" than this list, particularly given Mr. Vickrey's comments at a recent meeting that the bond measure for facilities is at best a 2006 possibility.	11a. While there may be an outstanding critical facilities need, the statewide impact of additional unallocated reductions represent a more immediate threat to court operations. Reprioritizing the capital outlay plan would essentially change the existing criteria for court facilities projects, giving precedence to those courts that had an ability to contribute reserves over those courts that may have a more urgent need based on the condition of their existing facility.

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Court	Comments	Response
Colusa	12. My suggestion is that you inform the Judicial Council that it is a matter of fairness, not business necessity that at least 50 percent of the money taken from the “donor” courts be returned to them as soon as there is any increase in the judicial branch budget. It seems that of all organizations, the judicial branch should strive for fairness within the branch. Further, I believe that the amount of reserves should be looked at closely, 10 percent for large courts is a lot of money. For small courts, it is a drop in the bucket. One large problem could deplete it in a single stroke. I am aware that we could come to the AOC, with hat in hand begging for a handout. However, that is not a good business model. I believe that 50 percent of that taken from all courts should be returned, without condition, illusory or otherwise. Secondly, the amount of the allowed reserved, in the future years should be pegged at 20 to 25 percent for the smaller courts.	12a. The Judicial Council has directed that staff review the appropriateness of the current reserve limit, and present further recommendations on the implementation of the reserve policy at a future council meeting. Reimbursement of reserves in the future will be based on the council-approved reserve limit in place at the time the reimbursement request is received.
Questions about the methodology		
Tehama	13. The initial question is, “who decides what is a critical business need”? Is it the court or is it the AOC? Furthermore, one must consider that with the loss of reserves we will probably be redirecting resources from “non-critical” needs to “critical needs”. Under this criteria those “non critical needs” could not later be funded.	13a. See response 5a.
Calaveras	14. The methodology does not indicate what level application, consideration or approval for reimbursement of reserves will be made (i.e., Judicial Council,	14a. Agree. The methodology has been revised to include the review process. Requests for reimbursement of reserves must be submitted to the court’s Regional

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	Administrative Director, Finance Director).	Administrative Director. An AOC executive team comprised of the Chief Deputy Administrative Director, the three regional directors, and the Finance Division Director will review, consider availability of one-time funding, and make recommendation to the Judicial Council on each request. This review process is consistent with the appeals process for trial court budget requests that has been in place for several years, as well as the process that was used to review trial court reserve reduction appeals.
Calaveras	15. How will funding to “resolve underfunding issues” be identified? (To date I am unaware of any such funding process.)	15a. Refer to response 1c.
Calaveras	16. It is not clear whether both criteria elements must be met or whether a court would qualify for reimbursement if either was met. If both criteria elements must be met, then some provision, in the event the critical business need of the courts exceed the approved reserve level, should be allowed.	16a. Both criteria must be met in order for a court to be eligible for reimbursement of reserves. That is, the sum total of the court’s TCTF reserves and the amount of reserves to be reimbursed cannot exceed the council-approved reserve policy limit <u>and</u> the court must have an essential business need for the funds. However, to the extent that the reserves will be used for an essential project, the court sum of the reimbursement and the court’s TCTF reserves can exceed the council-approved reserve level.
Other comments		
Calaveras	17. The criteria does not appear to differ much from the process currently available to any court to submit a deficiency funding request when they cannot meet their critical business needs.	17a. While there are some similarities, the threshold for deficiency requests is significantly greater than the proposed methodology for reimbursement of trial court reserves. The current trial court deficiency process takes into account both a court’s Trial Court

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		Trust Fund (TCTF) and Non Trial Court Trust Fund (NTCTF) reserve and fund balances, and contains an in-depth line item review of all expenditures by AOC staff. The proposed reserve reimbursement methodology only considers the justification by the court for an essential business need that cannot be met with existing resources.
Calaveras	18. Some qualifier should be tied to identify an “improvement in the state fiscal environment”. In FY 2004–2005 the Judicial Branch budget experienced both an increase in the budget, as well as unallocated reductions. Perhaps the qualifier could be tied to the new State Appropriations Limit methodology for Judicial Branch budget increases or some other tangible indicator.	18a. Agree. The methodology has been revised, and reimbursement is no longer contingent upon an improvement in the state fiscal environment. The methodology now reads, “Any reimbursement provided in accordance with the preceding criteria cannot be made prior to July 1, 2005, and must be completed prior to June 30, 2009”. With the implementation of funding based on the State Appropriation Limit, it is likely that FY 2004–2005 would be the last year that trial courts would have reductions taken. If this is the case, we should begin to realize savings in FY 2005–2006, which could be used for one-time reimbursement of reserves.